

Office of Chief Counsel
Internal Revenue Service

memorandum

CC: [REDACTED]:TL-N-3265-99
[REDACTED]

date: JUL 01 1999

to: Examination Division, [REDACTED] District, [REDACTED]
ATTN: [REDACTED], Revenue Agent, [REDACTED]

from: Associate District Counsel, [REDACTED] District, [REDACTED]

subject: [REDACTED]
Employment Tax Years [REDACTED] and [REDACTED]

This memorandum responds to your request for advice regarding the proper employment tax treatment of certain tax preparation services provided by [REDACTED] or the "Taxpayer") to its employees working in foreign countries.

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUE

Whether the amounts paid by the Taxpayer to its accounting firm for tax preparation services provided to its employees working in foreign countries constitute wages for purposes of federal income tax withholding, Federal Insurance Contributions Act ("FICA") taxes, and Federal Unemployment Tax Act ("FUTA") taxes.

CONCLUSION

Yes. The tax preparation services confer a direct and personal benefit on the employees and, accordingly, are includible in the employees' gross income.

(b)(5)(AC), (b)(7)a

[REDACTED]

FACTS

The Taxpayer is a Delaware corporation in the business of providing diversified professional technical services and high-technology products to various departments and agencies of the United States government, as well as foreign governments and commercial customers.

The Taxpayer sends several of its employees to work in foreign countries ("expatriate employees"). Due to this assignment, the expatriate employees incur individual income tax liabilities in the foreign countries and are required to file foreign income tax returns. In addition, the expatriate employees often incur foreign tax liabilities which exceed the U.S. income tax liability that they would have incurred had they remained in the U.S. In these circumstances, the Taxpayer compensates the expatriate employees for the additional tax liability. To receive the additional amounts from the Taxpayer, however, the expatriate employees must allow the Taxpayer's accounting firm to prepare their U.S. and foreign income tax returns.

During [REDACTED] and [REDACTED], the Taxpayer paid \$[REDACTED] and \$[REDACTED], respectively, for tax preparation and tax advisory services associated with its expatriate employees as follows:

Service

Tax compliance -
 host country
Tax compliance -
 U.S. federal and state
Tax equalization analysis
Other
Total

	[REDACTED]	[REDACTED]
\$	[REDACTED]	\$ [REDACTED]
\$	[REDACTED]	\$ [REDACTED]

It is unclear what the "other" services are.

The Taxpayer did not include these payments in the wages of the expatriate employees and did not withhold any amounts relating to these payments for purposes of federal income tax withholding, FICA, or FUTA.

The Service, however, has determined that these amounts are not excludable from the gross income of the expatriate employees under any provision of the Internal Revenue Code and are subject to withholding.

DISCUSSION

I.R.C. § 61 defines the term "gross income" to include all income from whatever source derived, unless it is specifically excluded by a provision in Subtitle A of the Internal Revenue Code. I.R.C. § 61(a); Treas. Reg. § 1.61-1(a). The term "gross income" includes income realized in any form, whether in money, property, or services. Treas. Reg. § 1.61-1(a). To illustrate, I.R.C. § 61(a) enumerates the more common items of income, including "[c]ompensation for services, including fees, commissions, fringe benefits, and similar items." I.R.C. § 61(a); Treas. Reg. § 1.61-1(a).

I.R.C. §§ 101 through 136, as well as other provisions, contain specific exclusions from gross income. The provisions that may apply to the facts of this case are I.R.C. § 132, dealing with fringe benefits, and I.R.C. § 911, dealing with foreign earned income.

Fringe Benefits

I.R.C. § 132 excludes from gross income any fringe benefit which qualifies as one of the following:

1. no-additional-cost service,
2. qualified employee discount,
3. working condition fringe,

4. de minimis fringe,
5. qualified transportation fringe, or
6. qualified moving expense reimbursement.

The term "working condition fringe" means any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under I.R.C. §§ 162 or 167. I.R.C. § 132(d). The term "de minimis fringe" means any property or service the value of which is, after taking into account the frequency with which similar fringes are provided by the employer to its employees, so small as to make accounting for it unreasonable or administratively impracticable. I.R.C. § 132(e).

In this case, the tax preparation services provided by the Taxpayer to its expatriate employees is neither a "working condition fringe" nor a "de minimis fringe." First, the expense for the tax preparation services in the hands of the employee is allowable as a deduction under I.R.C. § 212, and not under I.R.C. § 162 or 167, as required by I.R.C. § 132(d). Second, the value of the tax preparation services is not "so small as to make accounting for it unreasonable or administratively impracticable," because the Taxpayer is able to compute, and in fact has computed, the value for each expatriate employee.

The Taxpayer argues, citing several cases,¹ that the list of statutory exclusions from gross income is not exhaustive. All of the cases cited by the Taxpayer, however, were decided prior to the enactment of the Tax Reform Act of 1984 (the "1984 Act"). Prior to the 1984 Act, there was no statutory framework for determining the taxability of incidental benefits provided by employers to their employees. That is, I.R.C. § 61 did not specifically include fringe benefits in the definition of compensation for services, and there was no statutory provision defining which fringe benefits were excludable from gross income. As a consequence, the courts had the onerous task of determining which incidental benefits were includible in income and which were not, and the courts often reached inconsistent determinations. With the 1984 Act, Congress amended I.R.C. § 61 to clarify that the general rule of inclusion in gross income applied to incidental fringe benefits and added I.R.C. § 132 to codify the permissible exclusion of certain fringe benefits from

¹ Rudolph, et al. v. United States, 370 U.S. 269 (1962); Disney v. United States, 267 F. Supp. 1 (C.D. Cal. 1967); Ashby v. Commissioner, 50 T.C. 409 (1968); Dean v. Commissioner, 35 T.C. 1038 (1961).

gross income. Because the 1984 Act changed the framework for analyzing the taxability of fringe benefits, the cases cited by the Taxpayer are not controlling or persuasive.

The Taxpayer also argues that the value of the tax preparation services should be excluded from gross income, because the services are provided primarily for the benefit of the Taxpayer. According to the Taxpayer, "the purpose of sending the employees on overseas assignments is undoubtedly primarily for the benefit of the employer" and the additional tax liability incurred by the employees "is incurred primarily for the convenience of the [Taxpayer]."

Admittedly, the Taxpayer benefitted from the expatriate employees' taking the overseas assignments and by having its accounting firm prepare the income tax returns for the expatriate employees. By having the accounting firm prepare the returns, the Taxpayer could accurately compute the amount of the tax equalization payment and, therefore, would not pay the employees more than was required.

Nonetheless, the value of the tax preparation services provided by the Taxpayer is a direct and personal benefit to the expatriate employees. The expatriate employees are obligated by law to file federal income tax returns. I.R.C. § 6012. The tax preparation services provided to them by the Taxpayer had a direct bearing on their ability to fulfill this obligation. As a result, the receipt of the services conferred a direct and personal benefit on the expatriate employees, and the value received is included in gross income under I.R.C. § 61. See Rev. Rul. 73-13, 73-1 C.B. 42 (the value of financial consulting services, including tax return preparation, provided by a company to its executive is includible in gross income under I.R.C. § 61 and constitutes "wages" for FICA and FUTA tax purposes); see also Priv. Ltr. Rul. 8547003 (Aug. 27, 1985) (value of tax return preparation services provided by a company to its overseas employees is includible in gross income under I.R.C. § 61).²

In addition, the case to which the Taxpayer cites in support of its argument is distinguishable from this case. In McDonnell v. Commissioner,³ the taxpayer, an assistant sales manager for

² While Private Letter Ruling 8547003 does not have any precedential value, it does shed light on the Service's position on this issue. The facts in this ruling are substantially similar to the facts in this case.

³ T.C. Memo. 1967-18.

Dairy Equipment Co. ("DECO"), was chosen by lot to accompany a group of salesmen who had won company-paid trips to Hawaii. The taxpayer was instructed by DECO that he should consider the trip as an assignment, not a vacation, and that he must stay constantly with the salesmen-winners and must participate in all scheduled activities. DECO's "objective was not only to make sure that every winner enjoyed himself but to guide anticipated informal discussion relating to DECO's business in order to protect and enhance DECO's image with its distributors and territorial salesmen." McDonnell, T.C. Memo. 1967-18. In essence, DECO sent the taxpayer on a business trip. The Court concluded, therefore, that "there is not the slightest suggestion that the trip which the petitioners took was conceived of as disguised remuneration to them" and the expenses of the trip were not includible in the taxpayer's gross income. Id.

Unlike the expense in McDonnell, the expense paid by the Taxpayer is not a direct expense of the expatriate employees' overseas assignment. In McDonnell, DECO needed the taxpayer to accompany the salesmen-winners to Hawaii and paid the taxpayer's expenses to get to and stay in Hawaii. In this case, the Taxpayer needs the expatriate employees to work in foreign countries but is not paying the expenses to get them to or to stay in these countries. Rather, it is paying expenses indirectly related to the expatriate employees' work in the foreign countries and is paying them as an incentive or inducement for the employees to work in these countries. As the Court in McDonnell acknowledged, "the presence of an employer business purpose does not thereby preclude a finding of compensation to the employee." Id. And, as explained above, the value of the tax preparation services provides the expatriate employees with a direct and personal benefit.

The Taxpayer also argues, citing United States v. Gotcher,⁴ that the expatriate employees did not have any control over the benefits received from the Taxpayer, because they did not have any choice over whether to have their income tax returns prepared by the Taxpayer or who to have prepare their income tax returns. In Gotcher, the Court had to determine the extent to which the cost of a trip was includible or excludable from the taxpayer's gross income. In analyzing the issue, the Court focused on two important factors, whether the taxpayer had any choice but to go on the trip and whether the taxpayer had any control over the itinerary for the trip or the money spent. The Court concluded that the taxpayer did not have any control over the benefits that

⁴ 401 F.2d 118 (5th Cir. 1968).

he received and that the cost of the trip was not includible in the taxpayer's gross income.

(b)(5)(AC), (b)(7)a

1. (b)(5)(AC), (b)(7)a
2. [REDACTED]
3. [REDACTED]
4. [REDACTED]
5. [REDACTED]
6. [REDACTED]
7. [REDACTED]

(b)(5)(AC), (b)(7)a

Foreign Earned Income

I.R.C. § 911 excludes from gross income, at the election of a qualified individual, the foreign earned income of such individual and the housing cost amount of such individual. The term "qualified individual" means an individual who has his tax home in a foreign country and who either:

1. is a U.S. citizen who has been a bona fide resident of a foreign country for an uninterrupted period which includes an entire taxable year or
2. is a U.S. citizen or U.S. resident, who, during any period of 12 consecutive months, is present in a foreign country during at least 330 full days in such period.

I.R.C. § 911(d). The term "foreign earned income" means the amount received by such individual from sources within a foreign country which constitute earned income attributable to services performed by such individual during the period defined in I.R.C. § 911(d). I.R.C. § 911(b)(1). The amount of foreign earned income that may be excluded under I.R.C. § 911(a) is limited to \$70,000. I.R.C. § 911(b)(2)(A).

In this case, the value of the tax preparation services is considered an amount received by the expatriate employees from sources within a foreign country and is eligible for exclusion under I.R.C. § 911.

Income Tax Withholding and Employment Tax Consequences

If remuneration paid by an employer is excludable from gross income pursuant to I.R.C. § 132, it does not constitute wages for purposes of federal income tax withholding, FICA taxes, or FUTA taxes. I.R.C. §§ 3401(a)(19), 3121(a), and 3306(b).

If remuneration paid by an employer is excludable from gross income pursuant to I.R.C. § 911, it does not constitute wages for purposes of federal income tax withholding, but it does constitute wages for purposes of FICA and FUTA taxes. I.R.C. §§ 3401(a)(8)(A), 3121(a), and 3306(b).

Therefore, the value of the tax preparation services provided by the Taxpayer is subject to withholding for FICA and FUTA tax purposes but is not subject to withholding for federal income tax withholding purposes to the extent that it is excludable under I.R.C. § 911.

If you have any questions, please call the undersigned at [REDACTED].

[REDACTED]
Assistant District Counsel

By: _____

/s/
[REDACTED]
Attorney